

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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Telephone Number:

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CC:PSI:B03

PLR-136734-13

Date:

February 11, 2014

## LEGEND

X =

A =

B =

C =

GRAT 1 =

GRAT 2 =

Trust 1 =

Trust 2 =

Trust 3 =

Trust 4 =

Trust 5 =

Trust 6 =

Trust 7 =

Trust 8 =

Trust 9 =

Trust 10 =

Trust 11 =

Trust 12 =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Dear \_\_\_\_\_ :

This letter responds to a letter dated August 20, 2013, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

### FACTS

X was incorporated on Date 1 under State law and elected to be an S corporation effective Date 2. On Date 2, all of the issued and outstanding shares of X were held by individuals and GRAT 1, GRAT 2, Trust 1, Trust 2, and Trust 3. GRAT 1 and GRAT 2 were treated as grantor trusts under subpart E of part I of subchapter J of chapter 1 of the Code. On Date 3, GRAT 1 ceased to be a grantor trust and Trust 4, Trust 5, and Trust 6 were established as successor trusts. On Date 4, GRAT 2 ceased to be a grantor trust and Trust 7, Trust 8, and Trust 9 were established as successor trusts. Finally, on Date 5, their trustees combined the trusts as follows: Trust 1, Trust 4, and Trust 7 into Trust 10; Trust 2, Trust 5, and Trust 8 into Trust 11; and Trust 3, Trust 6, and Trust 9 into Trust 12 (collectively, the Trusts).

X represents that each of the Trusts satisfied all of the requirements of a qualified subchapter S trust ("QSST") within the meaning of § 1361(d)(3). However, A (the income beneficiary of Trust 1, Trust 4, Trust 7, and Trust 10), B (the income beneficiary of Trust 2, Trust 5, Trust 8, and Trust 11), and C (the income beneficiary of Trust 3, Trust 6, Trust 9, and Trust 12) failed to timely file elections under § 1361(d)(2)(A). Accordingly, X's S corporation election was ineffective on Date 2. Even if X's election had not been ineffective, X's election would have terminated on Date 3, Date 4, or Date 5.

X and X's shareholders represent that the circumstances resulting in the invalidity of X's S corporation election and the subsequent terminations (if the election had been valid) were inadvertent and were not motivated by tax avoidance or retroactive tax planning. Additionally, X represents that X and its shareholders have filed their federal income tax returns consistent with having a valid S corporation election in effect for X for all relevant periods, and that its shareholders have filed consistent with having valid QSST elections in effect as appropriate. X and X's shareholders agree to make such adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary with respect to such period.

### LAW AND ANALYSIS

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) defines an “S corporation” as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1) defines a “small business corporation” as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder. Section 1361(c)(2)(B)(i) provides that for purposes of § 1361(b)(1), in the case of a trust described in § 1361(c)(2)(A)(i), the deemed owner shall be treated as the shareholder.

Section 1361(d)(1) provides that if a QSST's beneficiary makes an election under § 1361(d)(2), such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1362(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1362(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(6)(iii) of the Income Tax Regulations provides that if S corporation stock is transferred to a trust, the QSST election must be made within the

16-day-and-2-month period beginning on the day that the stock is transferred to the trust.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides that if (1) an election under §§ 1362(a) or 1361(b)(3)(B)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(d)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under § 1362(d)(2) or (3) or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (3) no later than a reasonable time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation or a qualified subchapter S subsidiary (QSub), as the case may be, or (B) to acquire the shareholder consents, and (4) the corporation and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f) agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation or a QSub, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation or a QSub, as the case may be, during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we hold that X's election to be an S corporation was ineffective on Date 2, as a result of the failure of the beneficiaries of Trust 1, Trust 2, and Trust 3 to make the elections required under § 1361(d)(3)(A). Additionally, even if X's S corporation election had not been ineffective, we hold that X's S corporation election would have terminated on Date 3, Date 4, or Date 5 when stock was transferred to the remaining Trusts and the beneficiaries of those Trusts failed to make the elections required under § 1361(d)(2)(A). We also hold that the ineffective election and terminations were inadvertent within the meaning of § 1362(f).

We further hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from Date 2 and thereafter provided that X's election to be an S corporation was otherwise valid and was not otherwise terminated under § 1362(d) and that: A makes the required QSST elections for Trust 1, Trust 4, Trust 7, and Trust 10, with effective dates of Date 2, Date 3, Date 4, and Date 5, respectively; B makes the required QSST elections for Trust 2, Trust 5, Trust 8, and Trust 11, with effective dates

of Date 2, Date 3, Date 4, and Date 5, respectively; and C makes the required QSST elections for Trust 3, Trust 6, Trust 9, and Trust 12, with effective dates of Date 2, Date 3, Date 4, and Date 5, respectively. These elections must be filed with the appropriate service center within 120 days from the date of this letter. A copy of this letter should be attached to the QSST elections. If A, B, and C make the elections as instructed herein, the Trusts (as QSSTs) shall be treated as owning the X stock from the Trusts' respective creation dates. Accordingly, the shareholders of X must include in income their pro rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat X as described above, this letter ruling will be null and void.

Except as expressly provided herein, we express or imply no opinion concerning the Federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise eligible to be an S corporation for Federal tax purposes.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to X's authorized representative.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Stacy L. Short  
Senior Technician Reviewer, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Letter for § 6110 purposes